

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House  
(317) 232-9855

**FISCAL IMPACT STATEMENT**

**LS 6454**

**BILL NUMBER:** SB 191

**DATE PREPARED:** Dec 30, 2000

**BILL AMENDED:**

**SUBJECT:** Elimination of the Inheritance Tax.

**FISCAL ANALYST:** Jim Landers

**PHONE NUMBER:** 232-9869

**FUNDS AFFECTED:** X **GENERAL**  
**DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides a complete exemption from Inheritance Tax for property interests transferred to lineal descendants or ancestors (Class A transferees) with respect to persons who die after June 30, 2001. The bill phases out the Inheritance Tax on property interests transferred to Class B and Class C transferees by increasing exemptions over a three-year period beginning with transfers of persons who die after June 30, 2001. The bill also provides that no Inheritance Tax will be imposed upon property interests transferred to Class B and Class C transferees with respect to persons who die after June 30, 2003. The bill repeals the Inheritance Tax on July 1, 2006. The bill amends the Indiana Estate Tax formula and provides that the amended formula applies to the estate of a decedent who dies after June 30, 2003. The bill also makes conforming amendments.

**Effective Date:** July 1, 2001; July 1, 2006.

**Explanation of State Expenditures:** *Department of State Revenue:* Once the Inheritance Tax is completely phased out, there could be a savings to the state from a reduction in staff in the Inheritance Tax Section of the Department of State Revenue. The December 2, 2000, state manning table indicates that the Inheritance Tax Section employs 17 staff members with an annual salary cost of \$456,000. Since staff members would still be needed to process returns as the Inheritance Tax is phased out and since an estimate could not be made of the reduction in filings during each year of the phase-out, a specific savings due to staff reductions could not be estimated.

*County Inheritance Tax Replacement:* In addition to eliminating Inheritance Tax revenue to the state, the bill would, over a three-year period, eliminate the resident Inheritance Tax revenue retained by the counties. The revenue loss to counties is estimated to be approximately \$7.43 M statewide during FY 2003. As a result of the revenue loss, the bill would increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The maximum amount of county replacement for any year is \$7,452,000. The estimated amounts that would be paid to counties by the state for Inheritance Tax replacement beginning in

FY 2003 are specified below in Table 1. The impact on the state General Fund in the initial year or two of the phase-out may not equal the revenue loss to the counties since most are retaining more revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in the table below assumes that the revenue loss to the counties will be fully reimbursed by the state only in FY 2003. In each year after FY 2003, the county replacement cap of \$7,452,000 is expected to be reached. In addition, since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the impact that the bill may have on county replacement would be somewhat delayed.

**TABLE 1**

<b>Fiscal Year</b>	<b>State Expenditures for County Replacement</b>
2003	\$7,434,793
2004	\$7,452,000
2005	\$7,452,000

**Explanation of State Revenues:** The bill would lead to a progressively larger reduction in revenue from the Inheritance Tax from FY 2003 to FY 2005 when it is estimated that the state would no longer receive revenue from the tax. In addition, the bill could potentially lead to an increase in revenue from the Estate Tax. The bill could reduce Inheritance Tax revenue by an estimated \$86.11 M in FY 2003. The bill could also increase Estate Tax revenue by an estimated \$46.26 M in FY 2003. The net impact of the bill on state revenue is estimated to be a loss of approximately \$39.85 M in FY 2003. Further, the impact of state expenditures on county replacement increases the estimated loss to the state (net revenue loss plus county replacement expenditures) to approximately \$47.3 M in FY 2003. The estimated impact of the bill on Inheritance Tax and Estate Tax revenue and the net loss to the state including county replacement funding is presented below in Table 2.

**TABLE 2**

<b>Fiscal Year</b>	<b>Inheritance Tax Revenues</b>	<b>Estate Tax Revenues</b>	<b>Less: State Expenditures for County Replacement</b>	<b>Net Increase (Decrease)</b>
2003	(\$86,107,944)	\$46,258,830	(\$7,434,793)	(\$47,283,907)
2004	(\$89,233,989)	\$46,345,433	(\$7,452,000)	(\$50,340,556)
2005	(\$127,500,000)	\$48,637,283	(\$7,452,000)	(\$86,314,717)

**Background on Inheritance Tax:** The bill phases out the Inheritance Tax over a three-year period by providing a complete exemption in the first-year for transfers to Class A transferees and an increasing exemption during the three-year period for transfers to Class B and Class C transferees. In the third year of the phase-out, a complete exemption is provided for transfers to Class B and Class C transferees. The particular exemptions depend upon whether the person making the transfers died on or after specified dates. The exemptions and applicable dates are presented below in Table 3. (Under current law, Class A transferees are entitled to a \$100,000 exemption; Class B transferees to a \$500 exemption; and Class C transferees to

a \$100 exemption.) Since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the full impact of the first-year exemptions likely would not be experienced until FY 2003.

**TABLE 3**

<b>Class A Exemption</b>	<b>Class B Exemption</b>	<b>Class C Exemption</b>	<b>Transfers made . . .</b>
Complete	\$100,000	\$20,000	After June 30, 2001 and before July 1, 2002
Complete	\$120,000	\$24,000	After June 30, 2002 and before July 1, 2003
Complete	Complete	Complete	After June 30, 2003

The estimated impact of the bill is based on an Office of Fiscal and Management Analysis (OFMA) database consisting of Inheritance Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 112,951 transferee records. It is assumed that the sample is representative of the universe of persons paying the Inheritance Tax. Of the total tax liability for the sample, 39.43% is attributable to Class A transferees, 35.35% is attributable to Class B transferees, and 25.22% is attributable to Class C transferees. The estimated revenue loss is based on the Revenue Technical Committee's FY 2003 forecast for the Inheritance Tax equal to \$150 M. This total includes revenue from the Estate Tax estimated to be approximately 15% based on FY 2000 collections. This suggests that Inheritance Tax revenue is forecast at \$127.5 M. Given the distribution of Inheritance Tax liabilities in the sample, it is estimated that approximately \$50.28 M of this forecast are attributable to Class A transferees; approximately \$45.07 M are attributable to Class B transferees; and approximately \$32.16 M are attributable to Class C transferees.

The complete exemption of Class A transferees from the Inheritance Tax eliminates \$50.28 M in revenue as of the first year of the phase-out. The increase in the Class B exemption reduced the tax liability of the sample Class B transferees by 60.37% in the first year of the phase-out and 64.89% in the second year of the phase-out. The revenue loss from the changes in the Class B exemptions is estimated to be approximately \$27.2 M in the first year of the phase-out and \$29.24 M in the second year. The complete exemption of the Class B transferees in the third year of the phase-out would increase the revenue loss from this class to \$45.07 M. The increase in the Class C exemption reduced the tax liability of the sample Class C transferees by 26.83% in the first year of the phase-out and 30.21% in the second year of the phase-out. The revenue loss from the changes in the Class C exemptions is estimated to be approximately \$8.63 M in the first year of the phase-out and \$9.71 M in the second year. The complete exemption of the Class C transferees in the third year of the phase-out would increase the revenue loss from this class to \$32.16 M. Thus, the revenue loss for FY 2003 is estimated to be \$86.11 M and the revenue loss from the complete elimination of the Inheritance Tax is estimated to be \$127.5 M beginning in FY 2005.

*Background on Estate Tax:* The reduction in Inheritance Tax liabilities for some taxpayers could potentially have an impact on Indiana Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the federal state death tax credit (against the federal Estate Tax) exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an OFMA database of Estate Tax returns relating to a decedent who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. It is assumed that the sample is representative of the universe of estates paying the Indiana Estate Tax. The changes in Inheritance Tax exemptions in the first and second years of the phase-out led to a 205% and 206% increase, respectively, in the Estate Tax liability of the sample. Based on the FY 2003 revenue forecast and FY 2000 collections, Estate Tax revenue is estimated to be \$22.5 M. As a result, the revenue gain in FY 2003 is estimated to be approximately \$46.26 M due to the changes from the first-year of the phase-out. The complete elimination of the Inheritance Tax resulted in a 216% increase in the sample liability. Thus, the revenue gain from the Estate Tax in FY 2005 and after is estimated to be \$48.64 M.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** The phase-out of Inheritance Tax is estimated to result in a net revenue loss to counties beginning in FY 2004. The impact on the counties is presented below in Table 4.

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The estimated revenue loss statewide to counties beginning in FY 2003 is specified below in Table 4. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. Table 4 also specifies the amount of replacement funding the counties will receive beginning in FY 2003. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. Therefore, a reduction in tax retained by a county due to the bill would be reimbursed only to the extent that the changes made by the bill cause the amount of tax revenue retained by the county to fall below its guaranteed amount. Currently, most counties are retaining more Inheritance Tax revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in Table 4 assumes that the revenue loss to the counties will be fully reimbursed by the State in FY 2003 but not in subsequent years when the replacement cap of \$7,452,000 is reached. A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

**TABLE 4**

<b>Fiscal Year</b>	<b>County Inheritance Tax Revenues</b>	<b>State Expenditures for County Replacement</b>	<b>Net Increase (Decrease)</b>
2003	(\$7,434,793)	\$7,434,793	\$0
2004	(\$7,704,705)	\$7,452,000	(\$252,705)
2005	(\$11,008,696)	\$7,452,000	(\$3,556,696)

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** State Revenue Forecast, December 19, 2000.  
Bill Reynolds, Indiana Department of State Revenue, 232-2075.  
OFMA Inheritance and Estate Tax Databases.  
OFMA County Replacement Spreadsheet.